**QUESTION NO. 4: How should the phrase "predominantly over their own telephone exchange facilities," as that phrase is used in Section 271(c)(1)(A), be defined?**

Sprint believes that to give full import to the term "predominantly" as used in Section 271(c)(1)(A), the Commission must consider the term both qualitatively and quantitatively. As a quantitative matter, the word should be given its common meaning, that is, having ascendancy, influence, or authority over others; superior; dominating; controlling."[13] At a minimum, this means substantially more than 50%, as measured, e.g., by investment.[14]

More significantly, however, the term must be understood to describe a requirement that encompasses the relative competitive significance of the interconnector's network facilities. Independent back-office operations, for example, are important, but they do not by any means represent the undoing of the bottleneck which Ameritech Ohio and other Bell Operating Companies enjoy. As explained in Sprint's response to Question No. 6, the phrase "over their own telephone exchange facilities" refers to independent facilities owned by the competitor. The qualifying terms, exclusively or predominantly, must be understood to explicate and emphasize the importance of those facilities, and must therefore include local loop facilities. Thus, the phrase in question

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13 Webster's New Twentieth Century Dictionary Unabridged (1979).

14 The FCC has consistently interpreted the term "predominantly" to mean more than 50%. See e.g., Complaint of WNYC Communications Group Against Time Warner City Cable Group Request for Carriage, 8 FCC Rcd. 3925 at ¶ 4 (1993); Implementation of the Cable Television Consumer Protection and Competition Act of 1992, 8 FCC Rcd. 2965 at ¶¶ 4, 5 (1993). There is no reason to think that these precedents should not be followed in the case of Section 271.

should be defined to mean that the competitive carrier provides service to most of its customers in the state over its own facilities independent of any facilities that it may also lease from the incumbent carrier to provide service to fewer customers via resale or unbundled local network elements.

The legislative history of Section 271 supports this conclusion. When the "predominantly" language was added on the floor of the House,[15] a senior Member of the Commerce Committee stated that the provision required a competitor to own "more than 50% of the local loop and switching facilities" it used to provide service.[16] The same Member stated that, to determine the proportion of the network owned by the CLEC, regulators should "consider only the local loop and switching facilities."[17] Congress' repeated references to cable companies as the most likely facilities-based competitors similarly reflects an emphasis on local loop infrastructure in determining whether facilities-based competition exists.[18]

Furthermore, the Conference Report (and Section 271(c)(1)(A) itself) specifically states that carriers providing solely "exchange access" would not meet the requirements

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15 House Commerce Committee Chairman Bliley (R-VA) introduced a manager's "en-bloc" amendment which added the "predominantly" language to the bill. See 141 Cong. Rec. H8445 (daily ed. Aug. 4, 1995) (text of the amendment). The Conference adopted "virtually verbatim" the House provision which became Section 271(c)(1)(A). See Conference Report at 148.

16 141 Cong. Rec. E1699 (daily ed. Aug. 11, 1995) (comments of Rep. Tauzin (R-LA)).

17 Id.

18 See response to question 6.

of Section 271(c)(1)(A).[19] This statement again shows that Congress expected that facilities-based providers would own their own loops, since competitive access providers must rely on the incumbent LECs' loops to carry switched traffic.

This is the only interpretation of "predominantly" that is consistent with the goal of the Telecommunications Act. Competitors who must rely upon the incumbent to lease facilities to provide service to customers cannot and do not offer a real competitive alternative. Indeed, so long as competitors must or do lease facilities from the incumbent, the incumbent remains the underlying monopoly with all of the opportunity and incentive to harm, if not prevent, competition. The goal is to have local competitors construct and operate genuine facilities alternatives to the incumbent, so that the incumbent's monopoly power will be dissipated, and consumers will be able to enjoy the benefits of real choices in service quality, technology and value.

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19 See Conference Report at 147-148.

**QUESTION NO. 5: Can "predominantly" be measured on a percentage basis?**

As explained in response to Question No. 4, the term predominantly should mean that the competitive LEC provides its services mainly (at least more than half) over network facilities, including local loops, owned and controlled by it.

**QUESTION NO. 6: Should the term "predominantly," as that term is used in Section 271(c)(1)(A), be read to require predominant usage of the competitor's own loop facilities?**

Yes. As Sprint has explained in response to Questions 4 and 5, Section 271(c)(1)(A) requires that a facilities-based carrier must own its own loop facilities, and further that it must use "predominantly" those facilities in providing its local exchange services. Thus, the extent of the competitive carrier's loop facilities will be an important consideration in an assessment of whether the carrier meets the Section 271(c)(1)(A) standard. The competitive carrier's loop facilities should be extensive enough to establish it as a truly independent alternative provider of local telephone service and exchange access service.

# SECTION 271:

# LEGAL ANALYSIS OF THE STATUTORY CONDITIONS FOR BOC ENTRY INTO LONG DISTANCE

MCI TELECOMMUNICATIONS CORPORATION

Prepared by Jenner & Block

October 1996

## SECTION 271:

## LEGAL ANALYSIS OF THE STATUTORY CONDITIONS FOR BOC ENTRY INTO LONG DISTANCE

### INTRODUCTION

Section 271 of the Telecommunications Act of 1996,[1] provides the mechanism by which the Bell Operating Companies (BOCs) may apply for authorization to provide interLATA service originating in the states in their regions. Subsection 271(d)(3) of the Act sets forth the three-part substantive test that the Federal Communications Commission (FCC or Commission) must apply:

> The Commission shall not approve the authorization requested in an application . . . unless it finds that --
>
> (A) the BOC has met the requirements of (c)(1) and
>
> (i) with respect to access and interconnection provided pursuant to subsection (c)(1)(A), has fully implemented the competitive checklist in subsection (c)(2)(B); or
>
> (ii) with respect to access and interconnection generally offered pursuant to a statement under subsection (c)(1)(B), such statement offers all of the items included in the competitive checklist;
>
> (B) the authorization will be carried out in accordance with the separate affiliate requirements of section 272; and
>
> (C) the requested authorization is consistent with the public interest, convenience, and necessity.

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[1] Pub. L. No. 104-104, 110 Stat. 56 (to be codified at 47 U.S.C. §§ 151 et seq.).

Because section 271 must be interpreted consistent with its purposes and the purposes of the Act as a whole, Part I briefly explains those purposes. Then, drawing on standard tools of statutory interpretation -- text, structure, purpose, and legislative history -- Parts II-IV of this paper analyze the three substantive requirements set forth in subparagraphs (d)(3)(A)-(C). Part V discusses the process established by section 271, including the critical role performed by the Department of Justice ("DOJ").

## I. CONGRESSIONAL PURPOSE

Two fundamental facts underlie the telephony portions of the Act: local exchange markets are monopolies; the long distance market is competitive. The principal purposes of the Act, accordingly, are to bring competition to the local markets while preserving existing competition in the long distance market. See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, at ¶ 3, CC Docket No. 96-98,FCC 96-325 (rel. Aug. 8, 1996) (noting third goal of preserving universal service) (hereinafter "Order"), pet. for review filed sub nom. Iowa Util. Board v. FCC, Nos. 96-3221 and consolidated cases). Section 271 furthers the underlying statutory goal of providing to all consumers the benefits of competition in the form of lower prices, improved quality, and innovative services.

BOC entry into the long-distance market is inextricably tied to the development of local competition. The BOCs themselves argue that the promise of in-region entry into the interLATA market serves as an incentive for them to enter into, and fully implement, access and interconnection agreements with new competitors in their local markets.[2] The BOCs' view of section 271 as a form of incentive regulation that induces them to open their monopolies to competition is shared by members of Congress. As stated by Representative Bliley, the principal sponsor of the House bill, "the key to this bill is the creation of an incentive for the current monopolies to open their markets to competition." 141 Cong. Rec. H8282 (daily ed. Aug. 2, 1995) (statement of Rep. Bliley). The Commission has taken a realistic view of the counter-incentives, noting the inequality of bargaining power and the ability and incentive of incumbent local exchange carriers (LECs) "to discourage entry and robust competition" in local markets. Order ¶ 10. Nevertheless, to the extent that the prospect of future entry into the interexchange market serves as an incentive for BOCs to comply with the provisions of the Act opening up markets to local competition, granting 271 applications effectively eliminates that incentive. Premature entry into the long-distance market would therefore harm both local and long-distance competition.

At least equally important, the pre-entry conditions of section 271 ensure that the BOCs will not be permitted to provide long distance service while their current incentive and ability to discriminate against their long-distance competitors remain intact. After all, BOC entry

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[2] See, e.g., SBC Comments in CC Docket No. 96-98, at 11 (arguing that section 271 "serves as a powerful incentive" to ensure that BOCs "compl[y] with the sections of the Act designed to promote local service competition"); BellSouth Comments, at 7; Ameritech Reply Comments, at 7; Bell Atlantic Reply Comments, at 3. The BOCs urged before the Act's passage that such an incentive would be essential to fostering local competition. As one NYNEX executive candidly explained in December, incentives "are at the heart of this whole thing." The executive claimed that NYNEX provided competitive LECs open access to its network not just "because we're good guys," but as a means "to get into new areas of business." Telecommunications Reports, at 16 (Dec. 11, 1995) (quoting William Allan, VP-regulatory affairs).

under section 271 serves the public interest only insofar as it promotes even more long-distance competition, not if it undermines the substantial competition that already exists. As Senator Dorgan, a member of the Senate Commerce Committee, explained, "The fact is that the long distance market is a truly competitive market. We risk damaging that competitive market if the RBOCs are permitted to enter the long distance market prematurely." 141 Cong. Rec. S8464 (June 15, 1995).

The structure of the Act demonstrates that actual, effective competition in local markets, not the mere potential for competition, must be present before an in-region long distance application can be granted. Congress clearly believed that it was not possible to let the BOCs enter the interexchange market now without harming the public interest. Under current competitive and regulatory conditions, the control exercised by the Bell operating companies over bottleneck local telephone facilities gives them the ability to frustrate competition if they were allowed to provide interexchange services today. That is why the pre-conditions for in-region entry in section 271 exist and prohibit the BOCs from currently providing interexchange services directly or through an affiliate. If Congress had intended to open all markets to the BOCs immediately, it would have authorized immediate entry into in-region as well as out-of-region long-distance services.

Although delay of in-region entry until a BOC fully implements the competitive checklist is intended to give it an incentive to cooperate with would-be local competitors, entry is not automatic when this condition is satisfied. BOC cooperation is a necessary but not sufficient condition. Full implementation of the competitive checklist will facilitate the development of local competition, but it does not guarantee that it will take root, much less flourish overnight. Given the enormous advantages of long-time incumbency and the tremendous obstacles facing competitive LECs (CLECs), interconnection, access, and resale consistent with the requirements of sections 251 and 271 will not by themselves ensure that local competition will be achieved and the BOCs' local monopolies will be broken. Congress therefore included a facilities-based competition test in section 271(c)(1)(A) and a public interest test in section 271(d)((3)(C) that must be given meaning.

The overall design of sections 271 and 272 make clear that regulation is not, and may not be treated as, a substitute for effective competition in preventing bottleneck abuse. If Congress had concluded that regulation by itself could ensure that BOCs would treat unaffiliated interexchange carriers fairly and cooperatively while their bottleneck power remains undiminished, it would have allowed them to provide interexchange service simply subject to the nondiscrimination and complementary structural safeguards of section 272. Regulatory safeguards can play a significant role in controlling and remedying abuse of any residual bottleneck power the BOCs may have after they enter the interexchange market, and regulators can and should enforce them aggressively. But Congress understood that the BOCs can abuse their local monopoly power to discriminate against competitors and to cross-subsidize their competitive services in ways that regulators cannot effectively control. The only truly effective check on anticompetitive BOC conduct is local competition. As a result, BOC entry is barred unless and until the Commission finds not only that a BOC will comply with section 272, but also that significant competitive changes in local markets have occurred.

For these reasons, the Act mandates a sequence of marketplace events: first effective local competition; then BOC entry into long distance. One of the principal proponents of the Senate and conference bills stated:

> The basic thrust of the bill is clear: competition is the best regulator of the marketplace. Until that competition exists, monopoly providers of services must not be able to exploit their monopoly power to the consumer's disadvantage. . . . Telecommunications services should be deregulated after, not before, markets become competitive.

142 Cong. Rec. S688 (daily ed. Feb. 1, 1996) (statement of Sen. Hollings) (emphasis added); see 142 Cong. Rec. S697 (Feb. 1, 1996) (statement of Senator Kerrey) (only the conference bill "had sufficient provisions to ensure that the local telephone market was open to competitors before the RBOCs entered long distance"). Members of the House of Representatives shared the same intent and understanding. E.g., 142 Cong. Rec. E204 (Feb. 23, 1996) (statement of Rep. Forbes) ("[B]efore any regional Bell company enters the long-distance market, there must be competition in its local market. That is what fair competition is all about."); 141 Cong. Rec. H8458 (Aug. 4, 1995) (statement of Rep. Bunning) ("We should not allow the regional Bells into the long distance market until there is real competition in the local business and residential markets.") (emphasis added).

These two purposes -- encouragement of local competition, and protection of long-distance competition -- reinforce each other, producing one inescapable conclusion: the BOCs must not be allowed into the interLATA market until local competition has developed sufficiently to ensure that withdrawal of the BOCs' single incentive to cooperate will not kill nascent competition and that the local marketplace acts as a meaningful check on the BOCs' bottleneck power. Properly implemented, the Act will realize the best of all worlds in bottleneck power is significantly reduced and where enforcement of section 272 safeguards can effectively control abuse of any remaining bottleneck power.

Consistent with these principles, the legislative history demonstrates persuasively that Congress expected the Commission to focus heavily on the extent of competition in the local market. See page __ above (discussing legislative history). Congress unquestionably intended section 271 to incorporate a requirement that real, effective competition in the local market precede BOC interLATA entry.

The very existence of a "public interest" test in the Act reflects a legislative judgment that a BOC's satisfaction of the checklist does not prove the existence of real competition, and that more is required before BOCs should be granted interLATA entry. Congress' inclusion of the public interest test demonstrates that it intended truly effective competition to have taken hold before the BOCs would be allowed into long distance. Although it increases the likelihood that effective local competition will develop over time, full implementation of the checklist does not necessarily guarantee that such competition will exist at the time that a BOC applies for authority to provide in-region long-distance services.

From the beginning, the Senate bill included the public interest test as a condition of Commission approval of a BOC's entry into long distance. The well-understood effect of this public interest test was that the Commission could deny a BOC's application for entry despite its full implementation of the competitive checklist. Senators Burns, Packwood, and McCain all complained in their "Additional Views" and "Minority Views" following the Senate report that the test gave the Commission too much discretion. S. Rep. No. 23, 104th Cong., 1st Sess. 62, 70 (1995). Senator Hollings, on the other hand, approved the public interest test precisely because of that discretion. Id. at 67. Conversely, the absence of a public interest test in the House bill left too little assurance that true local competition would be realized before BOC entry occurred. See 141 Cong. Rec. H8458 (daily ed. Aug. 4, 1995) (statement of Rep. Bunning) (emphasis added) ("We should not allow the regional Bells into the long distance market until there is real competition in the local business and residential markets."). Faced with these concerns, the Conference Committee retained the "public interest" provision of the Senate bill. That decision was made to ensure that effective local competition would precede BOC long distance entry.

The public interest test also includes, as the BOCs contend, consideration of the effect of Bell entry on competition in the interexchange market. The Commission should examine alleged benefits as well as costs of BOC entry into the long-distance market. But it flies in the face of the structure and purpose of the Act for the BOCs to claim Commission consideration under the public interest test is limited to the effect of entry on interLATA competition. The Conference Report's statement that the Commission must consider "whether the provision of the requested interLATA services is consistent with the public interest" does not imply that only effects on the interLATA market are relevant. Because any objective evaluation of the state of long-distance competition demonstrates intense and effective rivalry, BOC entry will not increase the intensity of this competition. Accordingly, the decisive issue is whether competition in the local exchange markets eliminates the ability and incentive of the BOCs to obstruct this vibrant interexchange competition.

Whether enough local competition exists to reduce the risks of BOC long distance entry to tolerable levels depends on a variety of factors:

- the percentage of local customers that have actually switched to competitive carriers
- the percentage of local customers that could readily subscribe to competitive services equivalent in functionality, quality, and price to those of the BOC
- the extent to which new entrants have constructed their own networks using their own facilities, including the extent to which those costs are irrevocably committed (that is, sunk) and to which new entrants have control over the design of new service through their own switches or otherwise
- the extent to which new entrants can expand service to new customers in new areas without sinking additional resources
- the extent to which new entrants have achieved economies of scale and scope
- the extent to which the BOCs have unbundled network elements that it is not technically feasible to unbundle immediately
- the extent to which a permanent arrangement for local number portability has been implemented
- the extent to which universal service subsidies are collected, distributed, and administered on a competitively neutral basis
- pricing behavior of the BOCs, in particular whether they have responded to competitive entry in portions of the market by strategically targeted price reductions

The best evidence of competition is that new entrants have captured market share. While market share is not necessarily dispositive, it provides a telling indication of the strength of competition. See, e.g., United States v. Grinnell Corp., 384 U.S. 563, 571 (1966); Weiss v. York Hospital, 745 F.2d 786, 827 (3d Cir. 1984), cert. denied, 470 U.S. 1060 (1985);

Price Cap Performance Review for Local Exchange Carriers, 11 FCC Rcd. 858, 922 (1995). Accordingly, it would be appropriate to use market shares to establish rebuttable presumptions about whether local markets are, or are not, competitive.

In this approach, the FCC could presume that actual competition is not effective unless at least a specified percentage of business or residential customers in a state have switched to competitive LECs, or, alternatively, if a substitutable CLEC service equivalent in type, quality, and price is as readily available as BOC service to a higher percentage of these customers, even though they have not actually switched. For a CLEC's service to be equally available, it is not enough that the CLEC's network pass within a specified distance of businesses or homes: the cost of extending the CLEC network even another hundred yards to the customer premises may be prohibitive; and in the case of multi-tenant buildings, it may be impossible at any price. CLEC service is not equally available unless the CLEC can provide service within the same amount of time at the same price as the BOC. The BOC would also have to produce evidence of actual competitive offerings that customers purchase and use as substitutes for BOC local service. These presumptions would be rebuttable. A BOC could attempt to demonstrate, for example, that even though it had virtually a 100% market share throughout a state, effective local competition existed. But the burden of proof on the BOC would be even heavier than it would otherwise be.

Conversely, if more than a specified percentage of business or residential customers in a state have switched to competitive LECs, or if a substitutable CLEC service equivalent in type, quality, and price is as readily available as BOC service to a higher percentage of these customers, the FCC could presume that actual competition is effective. A BOC might be able to carry its initial burden of proof by showing that its state-wide market share had fallen below these levels, but other parties could rebut that presumption by showing, for example, that these figures are misleading because many customers in substantial portions of the state have no real competitive alternative.

**B. Other considerations**

Although the extent of local competition will be a principal consideration in the public interest inquiry, it is not the only one. Two related factors deserve specific mention.

First, the public interest requires that access charges be reduced to economic cost before BOC entry. For the reasons explained on page __ above, compliance with the competitive checklist in subparagraph (c)(2) requires reduction of access charges. But even if the competitive checklist were interpreted more narrowly, it would be contrary to the public interest to allow the BOCs to provide in-region long distance service while access charges remain significantly above the economic cost of providing exchange access. As explained on page __ above, permitting the BOCs to provide long distance service while access charges remain at their current inflated level would substantially increase their ability and incentive to impede both local and long distance competition. This does not mean that the BOCs must wait to submit applications under section 271 until the Commission's promised access charge reform proceeding is completed no later than next spring. Under the Commission's price cap rules, nothing prevents the BOCs from reducing access charges sooner.

Second, it would be contrary to the public interest to allow the BOCs to provide in-region long distance service before reform of the current system of universal service support is completed. A competitively neutral system is essential to permit local competition to take root, and any nascent competition will be vulnerable as long as the current system persists. Moreover, as long as the current system of "implicit" funding remains in place, the BOCs will have access to huge sums of ratepayer funds to subsidize (directly or indirectly) competitive ventures, and their would-be competitors will operate at a huge disadvantage.

Furthermore, if the BOCs a permitted to enter the long distance market before these essential telecommunications reforms are completed, the FCC and state commissions will lose the only leverage they have to obtain any cooperation from the BOCs in reforming access charges and universal service. Once the BOCs provide in-region long distance services, nothing will counter-balance their incentive to delay and defeat efforts to bring access to cost and to achieve a competitively neutral system of universal service support. And their incentive and ability to lessen long-distance competition will be unchecked.

**C. Limiting or extending the checklist - section 271(d)(4)**

Some BOCs have argued that if the Commission considered the effectiveness of local competition, the level of access charges, or the state of universal service reform, it would run afoul of the directive in section 271(d)(4) that "[t]he Commission may not, by rule or otherwise, limit or extend the terms used in the competitive checklist set forth in subsection (c)(2)(B)." This argument is misguided.

Subparagraph (d)(4) does not purport to constrain the Commission's exercise of its general discretion to assess and promote the public interest. Rather, it provides much more narrowly that the Commission "may not . . . limit or extend the terms used in the competitive checklist." All this means is that the Commission may not modify already existing checklist items. So, for example, the Commission may not require a BOC applicant to satisfy item (i)

## CERTIFICATE OF SERVICE

I hereby certify that on this 8th day of January 1997, copies of the foregoing Comments of the Telecommunications Resellers Association in Case No. U-11104 were sent via first class U.S. mail, postage prepaid, to all parties as indicated on the attached service list.

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January 8, 1997

**VIA AIRBORNE EXPRESS**

Ms. Dorothy Wideman
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
Lansing, Michigan 48911

**Re: Docket No. U-11104**

Dear Ms. Wideman:

Enclosed for filing, please find the original and sixteen (16) copies of the following documents on behalf of Sprint Communications Company L.P.:

1. Legal Memoranda;

2. Affidavit of Edward K. Phelan; and

3. Affidavit of Betty L. Reeves.

Please return one file-stamped copy of each document to me in the enclosed self-addressed stamped envelope.

Thank you for your assistance. If you have any questions, please call me at 913-624-6828.

Very truly yours,

Rich Kowalewski

Rich Kowalewski

RK:sjw
Enclosures
cc: Service List
(w/enclosures)

**STATE OF MICHIGAN**
**BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION**

| | | |
|---|---|---|
| **In the Matter, on the Commission's own Motion, to Consider Ameritech Michigan's Compliance with the Competitive Checklist in Section 271 of the Telecommunications Act of 1996.** | ) ) ) ) | **Case No. U-11104** |

**PROOF OF SERVICE**

Rhonda S. McLearen, being first duly sworn, deposes and states that on January 8, 1997, she served a copy of Sprint's Legal Memorandum, Affidavit of Edward K. Phelan, and Affidavit of Betty L. Reeves upon the parties listed on the attached service list via overnight mail.

Further, deponent sayeth not.

Rhonda S. McLearen

Rhonda S. McLearen

Subscribed and sworn to before me
this 8th day of January, 1997.

Sally J. Werts

Notary Public

SALLY J. WERTS
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**STATE OF MICHIGAN**
**BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION**

| | | |
|---|---|---|
| **In the matter, on the Commission's own motion, to consider Ameritech Michigan's compliance with the competitive checklist in Section 271 of the Telecommunications Act of 1996.** | ) ) ) ) | **Case No. U-11104** |

# SPRINT'S LEGAL MEMORANDUM CONCERNING SECTION 271 STATUTORY ISSUES

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